Lincoln City Council (pre-council session)
Police and Fire Pension Actuarial Valuation Report
March 13, 2006

Members present: Annette McRoy, Dan Marvin, Ken Svoboda, Patte Newman, Jon Camp, Robin Eschliman.

Member absent: Jonathan Cook

Personnel Dept.
Resource Staff: Don Taute, John Cripe, Paul Lutomski

Council Chair Ken Svoboda calls the meeting to order at 10:26 a.m. and invites Personnel Director Don Taute to introduce the other staff members. Don introduces John Cripe, Compensation Manager and Paul Lutomski, Pension Officer.

Don Taute: Report date is August 31, 2005. The experience of the pension was favorable for two main reasons. The first reason was that assets earned more than the long-term assumed rate of return (13.44% [page A-5] vs. 7.5% [page B-2]). The four year market value smoothing method of calculating actuarial funding value recognizes only ¼th of any given year's investment gains and losses [page A-5]. This means 1/4th of the gain was recognized and the rest will be recognized over the next three years. Some early 2000 returns, when returns were not that great, will DROP off. The second reason for the favorable experience was that pay increases were lower than assumed [page B-2 and E-7].

The employer contribution is discussed each year with Council during budget construction. It was lower than recommended [page B-4 column C vs. column G], but the return made up for it.

The Net Pension Obligation is $2.5 M. We have had discussions with the Mayor, Finance and Budget regarding the City contributing full normal cost. A draft proposal to change to the pension ordinance requiring this was mentioned. Mayor Seng may discuss this draft at the 11 a.m. meeting.

Fiscal Year to date return on assets thru February was 8.3%.

Paul Lutomski: Page A-1shows the present value of expected future benefits and expected future resources. The bottom box are liabilities detailed by retirants and beneficiaries, DROP members, vested terminated members, service rendered by active members and service expected to be rendered by active members. The total is $211 million. The top box shows resources to pay the liabilities.

Page A-3 shows the components of Normal Cost, the cost to provide benefits if all the assumptions are correct. Age and Service benefits are largest component of Normal Cost at 15.5%. Total normal cost is 18.61%. Members contribute an average of 7.89% leaving the City to contribute 10.72% of payroll. The pension is $6.2 million behind in its funding. If that is amortized over 10 years it would take another 2.36% of payroll to pay it off.

Page A-5 shows the smoothed value of assets. The last column is 2005. Beginning year value for cost and market are shown without the $11 million 13th check pool. At the 7.5% assumption, income was expected to be $10 million, but actual income at 13.4% was $18 million. Item 8 shows the expected income and adds 1/4th of the $8 million gain. The rest of it will be recognized in $2 million pieces over the next three years. The $809 thousand from 2004 will be recognized for two more years. The negative $140 thousand will be recognized for one more year and the negative $1.3 million will not be included next year. Funding value was $145 million and the return with smoothing was 8.5% even though the market value return was 13.4%.

Page B-1. The top box, column three shows funded percent. The fourth column shows Unfunded Actuarial Accrued Liability. It improved from $7.2 to $6.2 million. The bottom box shows the Annual Required Contribution mentioned when NPO was discussed.

Jon Camp: What did the City actually contribute last year?

Paul Lutomski : About $2.365 million.

Jon Camp: So it was $1.7 below.

Paul Lutomski: Yes.

Page B-4 shows historical NPO. It is now at $2.5 million and will get worse before it gets better.

Dan Marvin: It will come down because you are going to recognize the remainder of the $8 million.

Paul Lutomski: If the City contributes its full normal cost that will take care of everything but the $6.2 million underfunding. We will have to earn above 7.5% on assets to further reduce the $6.2 million.

Page C-1. the top box shows actuarial gains(loss). The year started out with a $7.2 million UAAL, or underfunding. If all assumptions occurred as expected the underfunding was expected to grow to $8.7 million, but it decreased to $6.2 million because of the good investment return. The bottom box shows gain/loss for prior years.

Pages D 1-3 are a Summary of benefit provisions

Pages D 4-7 show Retiree and DROP member data. Retirees 334, DROP 55 members

Pages D 9-12 show Active member data

> Page D-10: 288 police, average age 37.5, service 12.5 years, $53,491 pay
> Page D-11: 245 fire, average age 41.0, service 13.3 years, $55,608 pay
> Page D-12: 533 total, average age 39.1, service 12.9 years, $54,464 pay

Pages D 13 shows revenues and expenses. At the beginning of the year market value was $148 million. Members contributed $1.8 million, the City contributed $2.3 million and the EMS fund contributed $216 thousand. Interest was $626 thousand, dividends at $3 million, gain was $15 million for total revenue of $23 million. Expenses start with base pension payments at $4.8 million, and DROP payments at $2.1 million. The DROP includes lump-sum refunds of member accounts so the actual monthly figure is lower, about $1.7 million. Refunds were $587 thousand. Administrative expenses were $156 thousand. Investment expense was $117 thousand. This comes primarily from a JP Morgan real estate fund that charges quarterly fees. Last calendar year it earned 30%. Others include a JP Morgan fund of hedge funds and real estate with Rreef America. Finally, ending market value was $164 million and that includes the $11 million in the 13th check fund.

Section E is text and goes over the financial principles, actuarial process, detailed assumptions, and some technical terms.

Page E-9 shows the differences between Police and Fire regarding retention and retirement ages.

Jon Camp: Do you have any observations why Police retention is about half of Fire?

Don Taute: You would probably have to ask the chief. I would simply guess that after training the job is not what they were cut out to do.

Jon Camp: The chart shows Fire separations at about half the Police rate for any given time.

Paul Lutomski: The next page continues that theme and shows Police Officers will normally retire or enter DROP at a younger age than Fire Fighters. In general Fire works longer than Police.

Robin Eschleman: You mentioned the JP Morgan real estate earned 30%. Did that account for most of the 13.44%?

Paul Lutomski: The 30% was for calendar year 2005. I don't know what it earned in the fiscal year. The average for calendar year 2005 for real estate was 21% and it made up about 13% of the portfolio. Our other big earner was American Funds Europacific fund and I think it earned 25%. It might be 20% of the portfolio.

Dan Marvin: On page A-1, what is the $7.9 million adjustment for?

Paul Lutomski: That adjusts assets from market value to the smoothed number.

Jon Camp: Do we have a history of benefit payouts. Are we seeing any trends?

Paul Lutomski: No, but I will get those.

Ken Svoboda: Any other questions? Don any comments?

Don Taute: I hope we can continue to bring you good news. Mayor Seng may bring an ordinance mandating normal cost contributions to you.

Jon Camp: On the mix of investments, interest rates are being raised by the Fed. Real estate has done well. Do you have observations on what returns we might see in the near term. Are we reaching a point where real estate could take a dive? With interest rates going up, does that deflate our bond values?

Paul Lutomski: We started paring back our bond holdings a couple years ago. Our biggest holding is now the Calvert Income Fund with $17 million. It is a very actively managed portfolio and mostly short term. On real estate, the folks tell me the types of things they buy are mostly not retail buildings. They have warehouses, manufacturing plants, office buildings. They are going to talk to us in May. From what I gather those markets don't move in sync with the retail housing market that we are most familiar with. They move more with the general business climate and the economy.

Jon Camp: Perhaps we could meet with them.

Don Taute: I would like to add that the allocation mix is diversified.

Jon Camp: Is the mixture of assets shown in here.

Paul Lutomski: No, but I'd be happy to give you one.

Dan Marvin: Who drafted the ordinance to mandate full normal cost funding?

Don Taute: I did. Hopefully we will bring it forward soon.

Dan Marvin: Is it coming from the Mayor's Office.

Don Taute: Yes.

Ken Svoboda adjourns the meeting at 11:02 a.m.

City of Lincoln Nebraska
Police and Fire Pension

To: City Council Members

From: Don Taute, Personnel Director

Date: March 14, 2006

Re: City Council information requests re: Police and Fire Pension

During our presentation of the Police and Fire Pension Annual Actuarial Report four requests for information were submitted:

1. A history of benefit payments was requested. Page D-4 of the 8/31/2005 Annual Actuary Valuation is available on line at

   http://www.lincoln.ne.gov/city/person/PFpen/documents/Actuary082005.pdf

   and contains a history of benefit payments. The "Annual Benefits" column represents the annual total of all monthly pension benefit payments as of any given year ending as stated in the "Year Ended" column. We have reproduced this page for your convenience.

2. An expectation of real estate returns was requested. The "Market Overview" contained in J.P. Morgan's Strategic Property Fund Annual Report for September 30, 2005 states an expectation in the range of 7-8% for each of the three years following that date. We have reproduced the entire Market Overview for your convenience.

3. An asset allocation was requested. We have attached the January 31, 2006 asset allocation.

4. The pension's Investment Policy is available online at

   http://www.lincoln.ne.gov/city/person/PFpen/documents/InvestPolicy.pdf

   and contains Appendix "A" which is a list of allowable asset classes and corresponding allocation ranges.